

USAID/Croatia

Annual Report

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Croatia

Performance:

Background: Croatia has been building the elements of a participatory democracy and market-oriented economy since January 2000, with the election of a reformist coalition government. Croatia sees its future in full integration into the EU, where the engine of future growth lies, although wrenching societal changes will surely be needed to let it compete and thrive in the international marketplace. Croatia's advancement toward integration into regional and Euro-Atlantic institutions and developing positive relations with other states in Southeast Europe is essential to achieving U.S. foreign policy goals of improving regional stability in the Balkans and managing transnational threats.

Croatia has made significant, if still fragile, progress toward macroeconomic stability, growth, and strengthening of democratic institutions. Croatia's economy has undergone a remarkable transition over the last few years especially in terms of achieving macroeconomic stability. With macroeconomic reforms locked in, the Croatia's GDP rates grew from 3.8 in 2001 to 5.2 in 2002. In FY 2003, Croatia is expected to achieve a stable 4.5 percent GDP growth. Unemployment decreased to 14.1 percent (ILO methodology) for the first half of 2003, down from 15.2 for the first half of 2002, and 16.0 for all of 2001. The economy is gradually transforming, with services continuing to grow, and SMEs making up a greater share of the economy. Tourism, while an indispensable part of the economy, remains vulnerable to shocks and is in need of large infusions of capital and expertise.

Croatia's democratic transition has been less impressive. It lags Northern Tier states on all major reform indicators, although there have been significant improvements since 2000 in free and fair elections, civil society, independent media, improved governance, and rule of law. Recent parliamentary elections witnessed the reemergence of the Croatian Democratic Union (HDZ), the same political party which voters rejected in elections in January 2000 for their corrupt, nationalist policies which led to Croatia's isolation. The next Croatian government will be led by the HDZ, which captured a majority of the parliamentary seats making it the only party able to form a coalition government. During nearly four years in opposition, the HDZ went through significant internal changes, which its leaders claim have transformed it into a responsible, democratic party capable of continuing reform efforts in Croatia. These assertions are untested, however, and the HDZ has not participated in some of the national-level democratic reform processes supported by U.S. assistance in the past three years. The most important task of the Mission will be to consolidate these reforms and to convince the new government that it is in their interest to continue to work toward building Croatia's civil society.

Two of the leading challenges the new government will face are judicial reform and reintegration of refugees, both top conditionalities for EU accession. Croatia's judiciary continues to lag behind other areas of democratic development. Inefficient courts and outdated, often contradictory legislation led to huge case backlogs, predominantly in civil courts. Lack of progress in judicial reform is hampering Croatia's economic development; civil cases can take years to come to trial.

Progress toward re-integrating those members of Croatia's ethnic Serb minority displaced by the war was irregular and disappointing. Although the Government announced a series of measures aimed at encouraging the return of refugees and the restitution of their property, implementation lagged far behind expectations. One bright spot however was the passage of the new Constitutional Law on National Minorities, which gave minorities a new level of representation at both the local and national levels.

U.S. Interests: USAID's assistance program continues to be an integral tool in achieving U.S. national interests. SEED assistance resources enable the U.S. to support and, in some cases, accelerate Croatia's successful transition from Communism and the legacy of ethnic war. USAID programs are

aimed at ensuring that Croatia develops a fully democratic society and productive market-oriented economy that will serve as a cornerstone for peace and stability in Southeast Europe while promoting Croatia's aspirations for membership in NATO and the EU.

USAID assistance funds are used to assist Croatia in accomplishing these goals. Economic programs address SME and agribusiness development; improve the investment climate by accelerating the privatization process; and support the development of a competitive energy sector and promote interregional energy-sharing agreements between Croatia and its neighbors. Democracy activities concentrate on local government reform; strengthening non-governmental organizations (NGOs); political party and legislative strengthening; judicial reform; and anti-trafficking in persons. Refugee return and reintegration interventions continue to revitalize the economic sector in the war-affected regions. Social sector programs strengthen Croatia's pension reform and social dialogue programs.

Donor Coordination: As USG resources decline, EU and IFI programs are increasing significantly to support harmonization of Croatian with EU laws and policies. Croatia sees its future in EU membership, both in political terms and as the engine for future economic growth. This is a key underlying principle of our graduation strategy, including its timeline and recommended funding levels.

USAID has made good progress with the Commission and EU member state donors (as well as the IFIs) in ensuring our specific programs and long-term visions are complementary and reinforcing. Earlier this year a USAID-EU-IBRD collaborative effort on a common case-management system for the Croatian courts broke through GOC inertia to spark a real step forward toward improved judicial efficiency. USAID has been able to achieve similarly excellent cooperation on police assistance and refugee returns programs and see it evolving in other program areas as well.

Recently, the Mission submitted a jointly-developed EU-U.S. coordination paper to USAID, the Department of State and EU/Brussels. As a first step toward expanding EU and US cooperation, this paper describes coordination between our respective assistance programs in Croatia in terms of policy dialogue and program implementation. These practical efforts support the larger U.S. policy goal of encouraging the Europeans to assume lead responsibility for stabilizing and integrating this region of Europe.

Challenges: The notoriously inefficient Croatian justice system is one of the major disincentives to investment, and lagging reform in the sector is seen as a serious roadblock towards eventual EU accession. Several donor programs are working on various aspects of the problem with varying degrees of success. A Ministry of Justice in disarray and with little commitment to reform takes no leadership role in the reform process, and in many cases seems to be working against it. Multi-year case backlogs are common in courts throughout the country, and especially in the urban courts of Zagreb, Split and Rijeka. In response to this USAID had been working with the Ministry of Justice, without much success, to develop a common court case management software system for the municipal and commercial courts. Croatian legal experts and the Ministry of Justice (MOJ) were adamant that the procedural rules under which the municipal and commercial courts operated were so different that it would be impossible to have one common case management system. But as USAID and World Bank advisors led working groups of municipal and commercial court judges, it became increasingly clear that a common case management system was indeed feasible and much more cost efficient than running two separate systems.

USAID, the World Bank and the EU took a united front with the MOJ in favor of a common case management system that could be used in all of Croatia's courts. The combined efforts of the donors and the compelling logic of the proposal resulted in the Ministry's approval to move forward with the single court and case management system. The donors and the Ministry are now closely coordinating the design efforts of the system. The decision to proceed with a unified system is a clear win/win situation. The Croatian courts get a single court and case management system that will allow communications among all the courts and involve lower maintenance costs and improve much-needed judicial efficiency. The agreement also demonstrates the high degree of coordination among the international community donors in Croatia.

Key Achievements: With macroeconomic reforms well underway, USAID's recent focus on SME development in the agriculture sector has already achieved early results from piloted programs that will be expanding in the coming years. USAID's technical assistance to Croatia's Power Utility company (HEP) was instrumental Croatia's forward movement to becoming a regional leader in electricity interconnections. Croatia's NGO sector benefited substantially from USAID assistance to improve the legal environment for NGOs. The capacity of local governments to better manage their resources in a transparent and participatory manner was a direct result from USAID-provided technical assistance and training.

Economic Reform: USAID assistance focused on strengthening its SME and Agribusiness sectors to become more competitive. USAID's Croatian Enterprise Promotion Activity (CEP) established a sustainable Association for Management Consultants (AMC) set up to ensure quality standards for consultants in order to stimulate private enterprise productivity and profitability. USAID technical assistance was instrumental in the AMC's development of internationally-accredited standardization programs for ISO and Hazard Analysis of Critical Control Points (HACCP). As these standards are required by the EU, SMEs that receive accreditation in these programs will be better able to meet EU criteria for export purposes. Over 200 trainees representing more than 100 firms in the AMC have participated in these courses enabling them to deliver valuable business development services to a wide range of Croatian businesses. As a result recipients of the training have secured more than 300 paid contracts from interested local businesses representing more than 1 million Euros of revenue.

USAID's new Agribusiness Competitiveness Enhancement (ACE) program is strengthening the market linkages from the producers to final markets that had disintegrated from the break up of Yugoslavia. The project assisted a major fresh produce supplier in meeting the strict quality standards of the U.S. Military. As a result of two successful test shipments, the distributor has recently received a standing order for weekly shipments of produce to support U.S. forces in Kosovo that is expected to bring in more than 600,000 Euros in revenues over the next year. Two pilot projects demonstrated improved fruit and vegetable production resulting in increased yields and higher quality products that led to a commitment of a major food processor to transfer this new technology to its growers in the area during the next year. This multi-year program will provide technical assistance to over 3,000 agriculture producers and approximately 100 agribusiness enterprises that will ultimately increase employment in the sector, softening the blow that will certainly accompany privatization in the agriculture sector. Equally important, results of the program will enable Croatian agribusinesses to prepare for the daunting challenge of competing directly with heavily subsidized EU agriculture.

USAID-funded technical assistance played a key role in Croatia's progress towards the restructuring of its power sector. Croatia's geographic position and technical capability make it the leading actor in regional electricity interconnections and Croatia is pursuing the development of a Regional Electricity Market in Southeast Europe. The creation of an independent national power regulator to ensure fair and effective competition is the first step in this process, and technical assistance provided by USAID has enabled the Croatian Energy Regulatory Council to assert its strong role. Additionally USAID technical assistance provided concrete advice to the Croatian National Power Utility (HEP) resulted in a Memorandum of Understanding between the USG and HEP to provide further technical support in relation to tariff calculation, restructuring and eventual privatization.

Democracy and Governance: U.S. Government resources continued to strengthen Croatia's democratic institutions through a comprehensive development assistance program that includes activities such as political party and legislative strengthening; judicial reform; NGO and civil society development; and local government reform.

USG efforts to improve the legal environment for Croatia's non-profit sector achieved remarkable results during FY 2003. The USAID-funded International Center for Not-For-Profit Law (ICNL) provided a full range of legal, structural and organizational advice to the Government Office for Cooperation with NGOs that resulted in the enactment of new laws on Humanitarian Assistance and the National Foundation for Civil Society as well as a decree on the Distribution of the Lottery Proceeds to NGOs. These legislative enactments and governmental decree will provide an ongoing source of funding for local NGOs and

contribute to the overarching goal of creating a vibrant and sustainable NGO sector throughout Croatia.

USAID's NGO Support Program (CroNGO) has engaged citizens around the country as well as stronger, more professional organizations to take the leading role in advocating for delivering basic services to those disenfranchised sectors of society including HIV/AIDS and trafficking victims, the elderly and the disabled. Over 123 new community projects reached every county of Croatia and mobilized more than 16,000 citizens in FY 2003, bringing long needed change and improvement to communities. The CroNGO program is developing a sustainable core of nine sectoral and three grant-making NGOs which will serve as legacy mechanisms to ensure ongoing organizational and financial capacity building after USAID's graduation.

USAID's Local Government Reform Program (LGRP) has been instrumental in strengthening the capacity of over 400 of Croatia's 567 local governments that were left ill-prepared to take on the new and increased responsibilities devolved from the central government in 2001. Technical assistance modules in financial and asset management, local economic development and citizen participation in local affairs have provided local governments with valuable tools as they begin to manage their own affairs. As a result of this program, cities have adopted asset management reforms leading to increased revenues from assets that had never been used for income.

Return and Reintegration: The USAID-funded SEED program has been actively engaged in improving the living environment in ten municipalities in Croatia's war-affected area in order to promote the sustainable return of refugees and stability in the region. USAID's Community Infrastructure Program (CIRP) and Economic and Community Revitalization Activity (ECRA) have been successful in encouraging refugee return and improvement in the overall economic conditions in the regions. CIRP's infrastructure program has completed nearly 100 projects. The remaining projects are in the final implementation phase and will be completed in CY 2003, at which time the project will close. 55,000 people (about 18,000 families) in 144 communities benefited from restoration of eight community centers, fourteen schools, five kindergartens, a health clinic, two roads as well as renovated and rehabilitated water and electrical facilities. Water and electric projects that were implemented provided over 2,500 new or repaired connections to public utilities.

Economic and Community Revitalization Activity (ECRA) activities created employment for 716 people, generated 163 new contracts worth almost \$1,000,000 for assisted enterprises and leveraged close to \$500,000 of funding from other sources including commercial bank loans. Almost 10,500 people of all ethnic groups have participated in ECRA-assisted community activities and over 8,000 people received legal assistance - of which 45 percent had their cases resolved.

Social Transition Sector: USAID Croatia's Social Transition program addresses the mounting social ills and political disaffection originating from decades of socialism and post-independence economic contraction. Our activities enhance public understanding and support for social sector reforms, including the pension system, and support stakeholder negotiations on vital social reforms, such as labor and family laws. USAID's public education program on pension reform enabled the Government of Croatia (GOC) to win critical political will and popular support for this reform. Pension Reform has been highlighted as one of the GOC's most successful transition activities Croatia's pension reform program has become a model for all of Southeast Europe.

Through a USAID-funded public awareness activity, nineteen thousand copies of educational materials (posters, leaflets, brochures) on HIV/AIDS prevention were printed and disseminated to youth in Croatia's second largest city, the port town of Split. A local television station donated airtime for public service announcements and the project hotline has received about 145 calls since it opened in May 2003. As a result of this activity, free voluntary HIV/AIDS counseling and testing are now available both at designated NGO offices and in the city's public health clinic. To date, about 212 new clients have requested testing and counseling.

Gender: Because of both economic and equity issues, gender affects program performance in all four of USAID/Croatia's Strategic Objectives, and has been embedded throughout the portfolio. The program

consciously addresses the need for increased gender balance in areas such as advocacy through the Mission's NGO capacity building project and Labor Union and legislative strengthening activities. The country's serious economic problems and other political and social changes have affected both Croatian women and men in both rural and urban areas. In response, the Mission's enterprise promotion program, which includes specialized training in business development services, and our economic and community revitalization program in the war-affected areas strive for gender balance.

GDA: New Housing Solutions Program (NHSP): Of the three NHSP components, the Global Development Alliance, USAID's public-private partnership Development Credit Authority (DCA) loan guarantee program has been the best performer. USAID's Global Development Alliance component effectively stimulates local economies and demonstrates the viability of business opportunities for banks in war-damaged areas. Moreover, given its scope and structure, the DCA program will continue beyond the life of the SO and post-graduation. USAID's DCA loan guarantee component has been slow to start due to the Government's sluggish pace in meeting preconditions. However, upon resolving basic obstacles in the middle of CY 2003, USAID's partner bank, internationally-owned private bank Privredna Banka Zagreb, began implementing the home improvement loan component.

By the end of FY 2003, just three months into implementation, USAID had provided 189 loans with a total principal amount of \$1,158,278 (more than 15% of the first \$7,500,000 DCA apportionment). During the month of September the largest loan value to date (\$472,604) was placed, which represented more than 40% of the overall loan value. USAID's initial loan guarantee program is now leveraging private sector resources at a ratio of about 30 to 1.

During FY 2004, USAID will embark on a new DCA program geared at facilitating local governments' ability to develop energy efficiency projects in local government facilities. These would involve local primary and secondary schools, hospitals and public lighting. USAID is helping to identify the facilities and is preparing pre-feasibility studies. It's maximum Portfolio and Disbursement is set at 5 mil USD, USAID Liability is set at 50% i.e. a maximum of 2.5 mil USD. Loans under this DCA are to be provided until December 31, 2009. The maximum loan amount is 1 mil USD. Qualifying borrowers include Croatian municipal or other local governments and/or the corporations under their control.

Trade Capacity: Although the Mission's programs do not include a specific trade capacity building activity, several programs are aimed toward building the institutions of the Croatian government to support increased trade as well as building the competitiveness of the private sector to participate in the global marketplace. USAID assistance to the Ministry of Finance is improving the GOC's capacity to manage its financial affairs and lower its borrowing costs, thereby increasing the confidence of the domestic and international business and financial community in Croatia's future. Assistance to the financial sector is focused on increasing the safety and soundness of the banking sector through improved bank supervision capacity in the Central Bank. With the support from USAID's Competitiveness project, a structured high level public/private dialogue is underway with the goal of improving Croatia's competitiveness and integration into the global trading economy. Finally, USAID programs are working to improve managerial capacity in Croatian enterprises in order that Croatian goods and services meet international standards and can enter into world trade.

Country Close and Graduation:

Results Framework

160-0120 Fiscal Reform

160-0130 Growth of a Dynamic and Competitive Private Sector

SO Level Indicator(s):

- 1.3.1 Competitive, transparent privatization of state owned enterprises
- 1.3.2 Strengthened capacity of SMEs to operate and compete
- 1.3.3 Improved investment climate
- 1.3.2.1 Adoption of improved enterprise management systems
- 1.3.2.2 Strengthened business associations
- 1.3.3.1 Business friendly legal and regulatory framework
- 1.3.3.2 Improved transparency in government financial operations

160-0210 More Effective Citizen Participation and Improved Governance

SO Level Indicator(s):

- 2.1.1 More effective citizen participation in political and economic decision-making.
- 2.1.2 Sustainable and balanced commercial media
- 2.1.3 More efficient and responsive selected governance systems
- 2.1.1.1 Enhanced enabling environment for growth of effective CSO's and NGOs
- 2.1.1.2 Community-based civic action programs expanded/implemented
- 2.1.1.3 Improved capacity of the NGO sector
- 2.1.1.4 Strengthened political parties to be open, inclusive and representative of citizens
- 2.1.2.1 Journalists' professional standards improved
- 2.1.2.2 Management and business capacity of media organizations strengthened
- 2.1.2.3 Court administration modernized to support more efficient and responsive judiciary.
- 2.1.3.1 Local Government capacity to manage resources improved

160-0310 Accelerated Return and Sustainable Reintegration of War-Affected Populations

SO Level Indicator(s):

- 3.1.1 Infrastructure reconstructed and access to basic services provided
- 3.1.2 Community-based economic programs create jobs and output in war affected communities
- 3.1.3 Increased community reintegration
- 3.1.4 Information dissemination and outreach promote return of refugees
- 3.1.5 Market-based solutions meet housing needs of war affected communities
- 3.1.3.1 Social cohesion strengthened
- 3.1.3.2 Legal assistance promotes property restitution and access to social entitlements

160-0340 Mitigation of Adverse Social Conditions and Trends

SO Level Indicator(s):

- 3.4.1 Public acceptance of multi-pillar pension reform sustained
- 3.4.2 Tripartite dialogue contributed toward improved social and economic policies
- 3.4.3 Improved advocacy and protection for selected vulnerable groups

160-0420 Cross-Cutting Programs